



9 February 2015

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Aviation Working Group – Comments on the Leases Project

Dear Mr. Hoogervorst and Mr. Golden:

The Aviation Working Group (**AWG**) is an industry group whose members consist of the leading manufacturers, lessors and financiers of aircraft and aircraft engines. AWG has been closely following and reviewing with interest the leasing project activities of the FASB and IASB (the **Boards**). We have previously submitted comment letters on the exposure drafts and have commented on issues related to the project as they have arisen.

In this instance, we wish to convey our thoughts and observations regarding the Boards' recent tentative decisions on the accounting for sale leaseback transactions and to specifically comment on the following matters:

- The buyer-lessor's accounting for a sale transaction that does not meet the requirements for a sale under *Revenue from Contracts with Customers* (the "Revenue Standard");
- The scope of transactions that would be subject to the sale criteria in the Revenue Standard; and
- Whether purchase options are relevant to sale leaseback accounting.

When considering these matters, we assume a fact pattern where there is a sale leaseback and the lease includes a purchase option that is either considered *substantive* within the Revenue Standard

under the IASB's approach or not set at the then current fair market value under the FASB's approach and is therefore substantive.

The Buyer-Lessor' Accounting

The Boards have concluded that a buyer-lessor would account for a failed sale leaseback as a financing. The form finance accounting would take for the lessor may not be clear to lessors and users of financial statements, and it does not appear to be grounded in the accounting literature.

Staff Paper 3A/290 observes that finance accounting is consistent for the buyer-lessor with the "*financing method* for most failed sale and leasebacks under existing U.S. GAAP [par. 82]". This observation does not consider, however, that failed sale leaseback accounting in SFAS No. 98, *Accounting for Leases*, Appendix A [ASC 840-40-55-63], only addresses accounting by the seller-lessee and does not consider or include within its scope the accounting for the buyer-lessor.

Staff Paper 3A/290 proposed that a buyer-lessor should account for a failed sale leaseback by:

- Accounting for the full payment, including the value related to any unguaranteed residual asset, to the seller-lessee as a financial asset; and
- Accounting for any remaining balance at the end of the leaseback as the cost of the acquired underlying asset.

There are several issues with this presentation.

1. It leads to a mischaracterization of asset/residual risk as credit risk in a lessor's financial statements whenever the leaseback is for less than the full fair value of the asset;
2. It characterizes the residual as a financial asset, which is inconsistent with how financial assets are defined in the accounting literature; and
3. It is possible that a lease, which would otherwise be a Type B lease under the proposals, would be presented in a manner inconsistent with a lessor's other Type B leases, merely because the sale transaction failed to meet the revenue recognition requirements for the seller-lessee. The differing presentations would make it more difficult to analyze the lessor's portfolio and results of operations.

Based upon preliminary discussions we have had with investment analysts who follow the aviation finance industry, we believe users of lessor financial statements do not believe the proposed distinction between ordinary lease transactions and a failed purchase in the lessor financial statements is meaningful and this distinction will hamper their analysis of a lessor's financial statements.

Tentative decisions by the Boards on lessor accounting reflect a desire for there to be symmetry in lessee and lessor accounting for sale leasebacks and a desire to draw upon the concepts contained in the new Revenue Standard when developing the accounting for the sale component of a sale leaseback transaction. While the Revenue Standard approached the recognition of revenue and the passing of control from a customer perspective, it did not set out the accounting the customer would

have for a transaction within the scope of the Revenue Standard. Sale leaseback accounting is probably the first attempt to apply the customer perspective in the Revenue Standard to the actual accounting by the customer. Unfortunately, the outcome does not produce representationally faithful accounting and we believe that symmetrical treatment of sale leaseback transactions should be eliminated from a final leases standard.

Scope of Transactions Subject to Sale Leaseback Accounting

The tentative decisions on sale leasebacks will impact how these transactions are analyzed and accounted for. As a result, the determination of which transactions are -- or should be -- within the scope of sale leaseback accounting is a very significant matter. There are two classes of transactions that we believe warrant further consideration and clarification prior to the issuance of a final lease standard. The first involves lease transactions for newly delivered aircraft, and the second relates to the transfer of a purchase order position from an end user to a leasing company prior to the delivery of the aircraft.

For newly delivered aircraft that are sold by an airline to a lessor and leased back from that lessor, we do not believe the participation of the airline purchaser in what is destined to be a sale leaseback transaction is significant enough to warrant the characterization of the transactions as a sale leaseback. The airline is effectively acting as an agent of the purchaser in this case, with the effect that the substance of the transaction is a lease into the airline of the relevant aircraft from the buyer/lessor. Focusing on the sequencing of a lease will result in leases with similar terms being accounted for in very different ways. Therefore, we believe that sale leaseback transaction where the seller-lessee takes delivery from the manufacturer and within the same reporting period enters into a sale leaseback should not be within the scope of sale leaseback accounting.

In the aviation industry it is common for customers to make a deposit payment to the manufacturer in order to secure a position within the production schedule. This payment may be made years in advance of the plane entering production. Prior to delivery, the customer may transfer its position in the contract to a lessor and arrange for a lease of the aircraft when it is delivered. We believe it would be helpful if a final standard were to provide guidance on whether transfers of order positions in a purchase contract are (or are not) within the scope of sale leaseback transactions. In the case of an aircraft order, the deposit does not represent ownership interest in the underlying asset that is to be built and a transfer of the order position should not be within the scope of sale leaseback accounting. This clarification is needed as existing US GAAP includes guidance that specifies when a future lessee should be considered the owner of an asset during construction and the payment of a deposit usually results in the lessee being considered the owner of the asset during construction. While we expect this guidance will be eliminated when a new leasing standard is issued, we are not certain if this transaction would be outside the scope of sale leaseback accounting once the literature is removed from the codification. We believe the transfer of an order position does not represent a good or service transaction within the scope of the Revenue Standard. It does not involve the sale of the underlying asset as that asset has either not been constructed or the manufacturer's performance obligation has not been relieved.

Using Purchase Options to Determine Whether a Transaction is a Lease or a Financing

The lease accounting proposals will result in lessees recognizing lease assets and lease obligations in their financial statements. We are therefore troubled by the proposed use of the Revenue Standard to determine how much of an asset a seller-lessee recognizes, how a buyer-lessor recognizes revenue and how both parties depict their respective positions in their financial statements. Rather than passing sale leaseback transactions first through the Revenue Standard's criteria – as adjusted by the leasing proposals -- and then through a leasing standard, we believe it would be more appropriate to pass sale leasebacks only through a leasing model as this will produce a fairer presentation of the transaction, especially the position of the buyer-lessor.

In a sale leaseback transaction, using the control approach embedded in the Revenue Standard fails to acknowledge that the elements of control related to the purchase option are asymmetrical. While the seller-lessee may be able to obtain the rewards of the residual element of the leased asset, it is the buyer-lessor who retains the risks of the residual.

We respectfully request that this letter be distributed to all of the Board members. We would be pleased to discuss these comments further with the Boards and their Staff.

Sincerely yours,



Jeffrey Wool
Secretary and General Counsel
Aviation Working Group